No. 10,191

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

N. N. S. MATCOVICH,

Appellant,

vs.

RICHARD NICKELL, as Collector of Internal Revenue for the First District of California,

Appellee.

APPELLANT'S OPENING BRIEF.

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Subject Index

Table of Authorities Cited

Cases

Codes and Statutes

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STATEMENT SHOWING JURISDICTIONAL FACTS.

This action was brought to restrain the defendant, Collector of Internal Revenue from collecting an alleged tax due under the Federal Insurance Contributions Act and for contributions under Federal Employment Tax Act.

The matter comes before this Court on an appeal from a judgment based upon the granting of a motion to dismiss based upon the ground that complaint fails to show legal reasons for the Court to disregard the provisions of Section 3653 of the Internal Revenue Code and an order denying injunctive relief to plaintiff pursuant to an order to show cause for that purpose.

The main propositions upon which the complaint is based are: That plaintiff is not subject to either of the above referred to acts because the relation of employer and employee did not exist for which reason the alleged contributions were not due or collectible. That plaintiff would be irreparably damaged if the defendant collected the total amount alleged to be due, namely, $8271.45 because plaintiff was unable to pay said sum and that if defendant seized and distrains the property of plaintiff and sells the same, plaintiff's entire business would be lost and destroyed. Plaintiff therefore maintains that if the relation of employer and employee does not exist defendant had no right to enforce collection and since the equitable grounds are present the collector should be restrained notwithstanding the provision of section 3653 United States Internal Revenue Code.

FACTS ALLEGED IN THE COMPLAINT.

The following facts alleged in the complaint for the purposes of this case must be taken as true.

The complaint alleges that during the years 1938, 1939 and 1940 plaintiff conducted a dance hall in the city of Sacramento and that during that period, plaintiff licensed certain ladies to use said premises for the purpose of dancing. That said ladies were not employees of the plaintiff and did not come within the terms of the said Insurance Contributions Act or said Federal Employment Tax Act during said period since the operation of said acts are based upon the relation-

ship of employer and employee. That the only relationship which did exist between the plaintiff and said ladies during said period, was one of licensor and licensee, and that said ladies during said period were independent contractors. It is further alleged that an agreement was entered into between plaintiff with each one of the ladies dancing in the premises of plaintiff which granted each of said ladies the privilege of engaging in dancing with the patrons of plaintiff in his premises in consideration of the payment to him of the portion of the money earned by each of said ladies as mutually agreed upon. It is further stated in said agreement that it was the intent thereof that they should not become employees of plaintiff nor should be subject to his control. It is further alleged in said complaint that there was no other agreement of any kind entered into between plaintiff and said ladies. That said ladies during said period danced under the license issued to them pursuant to said agreement and under no other agreement or arrangement. It is then alleged that said tax assessments were erroneous, unlawful and void because the relation of employer and employee did not exist. And, therefore, the action by the defendant in attempting to levy a tax is an arbitrary and unlawful exercise of administrative authority. That a claim of abatement for said taxes and assessments were denied and that the defendant, unless restrained, will seize and restrain plaintiff's property under said authority of said tax assessment. It is then alleged that plaintiff has no plain, speedy, or adequate remedy at law for the reason that his action to determine the legality of said assessment may not be

brought except upon the payment of said tax assessment and a suit to recover it back. Plaintiff then alleges that he is unable to pay the said sum claimed $8271.45 without working serious and irreparable damage to his property and business which could not subsequently be remedied by the recovery of this tax by suit after payment. That if the defendant seizes and distrains the property of plaintiff and sells the same, plaintiff's entire business will be lost and destroyed which will result in the irreparable damage to him. That plaintiff then alleges that the reason he did not pay said tax during said period of 1939, 1940 and 1941 was because of the following facts and circumstances:

That all ladies desiring to dance in said premises of plaintiff entered into the license agreement under which agreement they were licensees only and not employees. That more than sixty ladies annually executed and operated under said licensed agreement during said period. That no claim of any kind was ever filed by any of said ladies, except during the year 1939 one Mary C. Mosier filed an application for compensation under the State Unemployment Act, which application was finally denied on the theory that she was not an employee. That during that same year the California Employment Commission filed an action in the Superior Court of Sacramento County to recover contributions based upon the alleged taxable wages of said ladies during the years 1936, 1937 and the first quarter of 1938. On the theory that the relation of employer and employee existed, Honorable Peter J. Shields, before whom said action was tried, held that

the commission was not entitled to recover because the relation of employer and employee did not exist. That all during said period, 1939, 1940 and 1941, no proceedings were taken by the defendant to collect any taxes. That it would be unjust and inequitable under those circumstances to compel the plaintiff to pay said taxes and assessments until such time as it be determined that said taxes and assessments are due from plaintiff.

LAW OF THE CASE.

The facts alleged in the complaint as a motion to dismiss must be accepted as true.

The motion to dismiss was based upon the ground that suit to enjoin or restrain the assessment or collection of taxes is expressly forbidden in Section 3653 of the U. S. Internal Revenue Code. The contention of the appellant is that before the tax or assessment can be levied and collected, the basic fact must be presented, namely, that the relation of employer and employee existed. Under those circumstances, if equitable grounds are present, the Court, in the exercise of its equitable jurisdiction will restrain the collection of the tax.

In the case of *Miller v. Standard Nut Margerine,* 284 U. S. 498 at page 509, 52 S. Ct. 26, 76 L. Ed. 422, the Court said:

> "Independently of, and in cases arising prior to, the enactment of the provision which became Rev. Stat. Section 3224, U.S.C. title 26, Section 154, this court in harmony with the rule generally

followed in courts of equity held that a suit will not lie to restrain the collection of a tax upon the sole ground of its illegality. The principal reason is that, as courts are without authority to apportion or equalize taxes or to make assessments, such suits would enable those liable for taxes in some amount to delay payment or possibly to escape their lawful burden and so to interfere with and thwart the collection of revenues for the support of the government. And this court likewise recognizes the rule that, in cases where complainant shows that in addition to the illegality of an exaction in the guise of a tax there exist special and extraordinary circumstances sufficient to bring the case within some acknowledged head of equity jurisprudence, a suit may be maintained to enjoin the collector."

The action of *Midwest Haulers Inc. v. Brady, Acting Collector,* 128 Fed. (2d) 496, decided June 2, 1942, was brought to enjoin the collection of additional taxes assessed against plaintiff under Title VIII and IX of the Social Security Act. It is there claimed that the additional tax was illegal and that the collection of them would cause the irreparable injury and would destroy its business and that it was without an adequate remedy at law. The lower Court granted a motion to dismiss based upon Section 3653 of the Internal Revenue Code. The Court said:

"Appellant concedes that the statute applies to all assessments and collections of Internal Revenue taxes made or attempted to be made under color of office by Internal Revenue officers charged with general jurisdiction over the assessment and col-

lection of such taxes, but it argues that notwithstanding the statute, courts have the power to restrain the assessment or collection of taxes where the remedy of the taxpayer at law to recover a tax illegally assessed or collected, is inadequate, or where there exists extraordinary and exceptional circumstances which bring the case within some settled field of equitable jurisdiction or where the exaction sought to be restrained is not within the definition of a tax. The question thus simmers down to whether appellant has stated a case not covered by the Statute."

The Court then, in its opinion, reviews the allegations of the complaint which showed the tax to be illegal and also that the enforced collection would result in a total loss of business. The Court then said:

"(2-5) Section 3653 of the Internal Revenue Code is not an absolute bar to every action to restrain the collection of an illegal tax. Hill v. Wallace, 259 U. S. 44, 62, 42 S. Ct. 453, 66 L. Ed. 822; Miller v. Standard Nut Margarine Co., 284 U. S. 498, 509, 52 S. Ct. 269, 76 L. Ed. 422; Dodge v. Osborn, 240 U. S. 118, 122, 36 S. Ct. 275, 60 L. Ed. 557. The genesis of this statute is found in Section 19 of the Act of March 2, 1867, ch. 169, 14 Stat. 475. Originally, it was an amendment of the Internal Revenue Act of July 13, 1866, ch. 184, 12 Stat. 152. The Act of which it was made a part expressly provided for a remedy at law by suit to recover taxes erroneously or illegally assessed or collected. In its present language it appeared in the Revised Statutes independently of the Revenue Act as R. S. 3224. Its original and

present setting require that it be construed in pari materia with other parts of the Internal Revenue Act which give to a taxpayer the unqualified right of recovery of all that has been illegally exacted from him under the guise of a tax. Snyder v. Marks, 109 U. S. 189, 3 S. Ct. 157, 27 L. Ed. 901. When it is made to appear that the rights and property of an alleged taxpayer will be utterly destroyed if he is compelled to pay a tax that is not in fact his obligation and the pursuit of his remedy by suit for the recovery will not adequately restore to him that which he has lost, a court of equity may take jurisdiction to grant relief in advance of payment notwithstanding the prohibition in Section 3653. The complaint in the case at bar, the allegations of which are admitted by the motion to dismiss, alleges facts which if true, show that the taxes sought to be collected by the appellee from appellant probably are not in fact due and the allegations further show that appellant's principal assets are intangibles composed of contracts with the owners of carrier's equipment and Universal and certificates of convenience and necessity for the use of the public highways of the states in which appellant is authorized to conduct its business. The allegations further show that these assets could not be sold at forced sale at any price and that a sale of the other assets of appellant will incidentally destroy its intangibles. It thus appears that the collection of the taxes alleged to be due by distrain and sale would destroy property of appellant, the the value of which it could in no way recover through the processes provided under the Internal Revenue Law.

In our opinion the case at bar comes within the exceptions to Section 3653 of the Internal Revenue Code stated by the Supreme Court in Hill v. Wallace, supra; Dodge v. Brady, supra; Allen v. Regents, 304 U. S. 439, 449, 58 S. Ct. 980, 82 L. Ed. 1448; Raymond v. Chicago Union Traction Co., 207 U. S. 20, 39, 28 S. Ct. 7, 52 L. Ed. 78, 12 Ann. Cas. 757.

Judgment reversed and cause remanded for further proceedings consistent with this opinion."

Under the above authorities, we submit the complaint does state a cause of action for the relief requested, for which reason the judgment should be reversed.

Dated, Sacramento, California,
September 18, 1942.

Respectfully submitted,
R. H. SCHWAB,
Attorney for Appellant.